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TAGS: [EFIN](#) [ETRD](#) [EAIR](#) [PTER](#) [LE](#)
SUBJECT: LEBANON: CENTRAL BANK GOVERNOR POINTS TO SLOW
GROWTH AS MAJOR PROBLEM

Classified By: Charge Michele J. Sison for
reasons 1.4 (b) and (d)

SUMMARY

11. (C) In a February 18 meeting, Lebanese Central Bank Governor Riad Salameh painted a picture for Charge Sison of a Lebanese economy hampered by slow growth and not keeping up with its neighbors. The GOL needs the continued financial support of other countries to cover its deficits. He would welcome an additional \$1 billion Saudi deposit in the Central Bank reserves, but so far has no confirmation of its arrival. Salameh has plans to bridge an expected government financing gap in March, but if he has to issue U.S. dollar CDs, they will be expensive. He does not want to weaken the Central Bank balance sheet by using reserves. Policies at the Central Bank will not change due to the recent Standard & Poor's downgrade. Salameh feels positive about efforts by Lebanese authorities and banks to combat terrorism finance. End summary.

CONSEQUENCES TO SLOW GROWTH

12. (C) In a February 18 meeting with Charge and Econoff, Central Bank Governor Riad Salameh explained the impact of Lebanon's five percent GDP growth, cumulatively over the last three years, compared to the 20 percent growth of neighboring countries. First, insufficient new jobs have been created. Newly created positions have low salaries, frustrating those who remain, and driving emigration, which will have a big impact on Lebanon's demographic balance. Second, purchasing power has decreased, especially during 2007, with a 10-15 percent reduction in purchasing power that year alone. Higher commodity prices resulting from the weak dollar, and rising oil prices drive that figure. Salaries cannot adjust in response, because there is no increase in efficiency in the local economy. The third impact has been the increase of the debt and the deficit. Lebanon's debt now totals \$41 billion, for an economy with a GDP of \$24 billion. The Central Bank (CBL) has managed this so far by taking \$15 billion out of the CBL reserves, paired with the Paris III loans and grants.

STRONG BALANCE SHEET,
BUT NEEDS FOREIGN DEPOSITS

13. (C) For the government, there is a gap of \$3 billion between the money available and that required. The interest payments alone are \$1.3 billion. For this reason, Salameh said, he suggested to the Prime Minister that Lebanon seek foreign deposits. The Saudis reportedly pledged to make a \$1 billion deposit in the CBL, but so far he has not received confirmation of that deposit. He hopes it will arrive in time to meet the expected gap in financing in March. His plan is to fill in the gap with dollar deposits. The balance sheet will be strong, with a high level of US dollar deposits, and a good stock of gold. There is currently \$97 billion on the CBL balance sheet, four times the size of the economy.

14. (C) If the CBL is required to cover the \$3 billion government deficit out of its reserves, it will weaken the CBL balance sheet and create a loss of confidence. Salameh can always issue CDs in U.S. dollars, but the interest, at nine percent, will be considerably higher than the four percent he will pay out for Saudi and other foreign deposits. The Prime Minister was in Kuwait to raise this issue, and will return to raise it again, but Salameh is not confident Kuwait will act with sufficient speed. This week the Prime Minister is in Paris to sign the final loan agreement with

the French; there is nothing additional promised by the French after that.

NO POLICY CHANGES
DESPITE S&P DOWNGRADE

15. (C) Although one of the key rating agencies, Standard & Poor's, has downgraded GOL paper from B- to CCC, the CBL will not change its policies, but will monitor the situation.

BEIRUT 00000268 002 OF 002

He does not expect the Lebanese commercial banks to provide the GOL financing needs. Due to their high liquidity, the banks recently have been using their assets to buy internationally, and are doing well.

16. (C) In addition, the Lebanese pound is doing well; it is stronger than the U.S. dollar, on which it is based. In fact, at this point the only vulnerability that Salameh sees is the GOL. He sees 2008 as a difficult year, both economically and socially for Lebanon, but a normal year financially. However, political instability is causing issues; a large Arab investment group postponed this week the debut of a large fund due to the ongoing political turmoil. Salameh does not foresee any catastrophes, but the future will see a decrease in interest rates. That will not be bad, according to the Governor, since the spread is currently too large. For 2008 he expects good inflows, and a five percent increase in inflation. There might be a new president soon, but if not, everyone will try to keep hope alive. Salameh said with resignation "Everyone knows that it will not be the Lebanese who decide on a president."

TOOLS TO RE-CREATE
A MIDDLE CLASS

17. (C) In Salameh's opinion, an improved economy will have a positive political impact. If the GDP doubles, as he hopes, and jobs are created, the cost of getting people "into the street" for protests will be much higher; many of the demonstrators are currently unemployed. In the mean time, the CBL will try to boost the prosperity of the middle class through monetary policy. This includes a lower interest rate, loans and other financial vehicles. The CBL has played its part by encouraging the commercial banks to use their normally non-interest-bearing deposits for special loans to consumers. Salameh is concerned that those who want to undermine Lebanon will try to hit the economy during the best part of the economic cycle - in the summer tourist season.

ON COMBATTING TERRORISM FINANCE

18. (C) Salameh feels positive about the work the CBL has done to combat money laundering and terrorism finance. Recognizing that a good reputation will bring in additional deposits, the banks are also very committed, and keen to apply the bank circulars on these subjects. Halawahs are fully regulated, and all deposits are traceable. They are particularly careful with charities who often deal in cash. As far as cash smuggling, all cash must be declared at the border, but it was known, for example, that after the July 2006 war reparations in the south were often paid in U.S. dollars. As Salameh says, "If they can smuggle in missiles, they can smuggle in cash," but the banks will not accept cash deposits. Salameh said he wished UNSC resolutions were more precise, which he said would help the CBL in implementing them more effectively.

MEA WILL BE SOLD,
BUT NOT YET

19. (C) As for Middle East Airlines (MEA), owned by the CBL, the time to sell is not now, according to Salameh. Plans were in place to do so in 2006, but the July-August war changed that. The financial advisors in place to assist with the sale advised the CBL, which owns 99 percent of the airline's shares, to wait or lose half the value. Salameh wants to sell off the carrier 25 percent at a time, to a broad spectrum of Lebanese shareholders, and by doing so create a new culture of share ownership. MEA is now worth \$700 million, which is twice what it was worth when the CBL was forced to take it over. Although it is run as a commercial operation, it also operates in response to GOL needs, as in continuing to fly in 2006 when other carriers refused to enter Lebanon.

110. (C) Salameh welcomed the February 24-26 visit of Treasury DAS Andrew Baukol, and is planning a trip to Washington to meet with the IMF prior to the spring meetings.

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